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Perspective

Decline and fall of OPEC

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It's been 10 years since the world took notice of the Organization of Petroleum Exporting Countries. By 1970-71, OPEC had managed to take over gradually the oil concessions which had been granted to multinational oil companies. By the summer of 1973 the price of oil had doubled, and there was talk of an oil crisis and of embargoes. But it was the October, 1973, war that propelled OPEC into public consciousness.

Production cutbacks by Arab producers, ostensibly in retaliation for U.S. help to Israel, speeded up an inevitable increase in the price—it quadrupled to \$12 a barrel. The suddenness of the increase and the fear of a declared embargo—which turned out to be quite ineffective except psychologically—threw the world into a panic and established the myth of Arab oil power.

This myth was reinforced in 1979-80 when the price tripled to about \$34, mainly as a result of panic buying by consuming nations and strategically timed cutbacks by Saudi Arabia. But this time OPEC overreached. By allowing the price to go too high they set the stage for their fall. We are seeing the beginning of this phase now.

What did OPEC accomplish in a decade and how did they lose their grip?

The story that emerges is one of a series of misjudgments—largely because they accepted the pessimistic assessment of Western experts and statesmen about the impending depletion of oil. Hadn't President Jimmy Carter promised a catastrophic oil crisis by 1983 when world demand would outstrip supply? And wasn't his forecast backed up by governmental studies (including the CIA's) and by private study groups sponsored by prestigious academic centers? And wasn't a government program on synthetic fuels financed with some \$80 billion as a starter and thought of as essential to Western survival?

It's not surprising OPEC, and especially Saudi Arabia, believed not only that the oil price could rise to the level of synfuels—more than \$50 a barrel—but that demand would hardly be affected by higher prices. They listened to the wrong experts. Over half

of the world's oil is used as a fuel just to make heat and steam. It can be replaced directly by cheaper natural gas, coal or nuclear energy where available, without waiting for synthetic oil.

This is exactly what happened. The world has seen a massive conservation program, including long-term measures to replace oil by cheaper energy sources and reduce its use by more efficient devices. These efforts require massive capital investments and take time. But once accomplished, these measures phase out oil even if its price drops; nobody will tear out the insulation in his house once it has been installed.

OPEC made another mistake by defending the price of \$34 even though it was too high. They did this by cutting their production: OPEC, as a whole by nearly 50 percent; Saudi Arabia by 70 percent. But the high price from 1979 onward simply encouraged more conservation investments. Oil demand in the industrialized countries [OECD] has fallen by 20 percent and can be expected to continue to decline. A further 20 percent decline will make OECD independent of imports from OPEC, assuming non-OPEC oil production grows modestly.

In assessing OPEC's fate for the coming decade—and especially that of the Arab producers—it is important to note that the Arabs never had "oil power," that is, the ability to set up a targeted embargo or to raise the price with impunity. [The 1973 experience proved the first point, the 1979 experience the latter.]

They are also finding that financial power—an important item economically and politically—can be a transient thing. One trillion dollars was transferred to oil producers in the last decade, of which only \$250 billion was saved, principally by the Saudis and other producers on the Arabian peninsula. But this amount is declining, as swollen budgets overwhelm much reduced oil revenues. And it could disappear much faster if the leaders of the oil countries panic. It will be difficult for them to decide where to cut expenditures in a politically safe manner.

The West, it turns out, was too successful in selling the world on the notion that an energy crisis was imminent. So successful were our leaders that even those who should have known better, like the Saudis, were driven to take measures they are now living to regret. Just as oil power was a creation of our collective imaginations, so are we learning was Arab power.

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